November 21, 2024

James P. Sheesley, Assistant Executive Secretary
Attention: Comments—RIN 3064-AF99
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions; RIN: 3064-AF99; Document Number 2024–18214; 89 FR 68244 (Aug. 23, 2024)

Dear Mr. Sheesley:

Better Markets[1] appreciates the opportunity to comment on the proposed rule ("Proposal")[2] from the Federal Deposit Insurance Corporation ("FDIC" or "Agency") that would amend important aspects of the FDIC's regulations governing brokered deposits. The proposed amendments address a significant and inappropriate narrowing of the types of deposits that are defined by regulation as "brokered," which the FDIC Board approved by a three-to-one vote on December 15, 2020 ("2020 changes" or "2020 rule").[3]

As described in more detail below, over-reliance on brokered deposits has consistently been demonstrated to be an important contributor to bank failures, and it has been a subject of concern among bank supervisors since the 1970s. The incentive among weak or aggressively risk-taking institutions to fuel their growth using brokered deposits reflects the moral hazard problems inherent in deposit insurance. Having adequate constraints on weak banks' ability to act on these misaligned incentives is of fundamental importance to maintaining a safe-and-sound banking system, thereby reducing the likelihood of future crises requiring taxpayer-funded government bailouts of badly managed banks.

The FDIC described its goal for the 2020 changes as to "take into consideration current industry practices and . . . allow for continued innovation."[4] The effect of the 2020 changes,

---

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions; RIN: 3064-AF99; Document Number 2024–18214; 89 Fed. Reg. 68244 (Aug. 23, 2024), https://www.govinfo.gov/content/pkg/FR-2024-08-23/pdf/2024-18214.pdf.

3 *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions Final Rule, 86 Fed. Reg. 6742 (Jan. 22, 2021), https://www.govinfo.gov/content/pkg/FR-2021-01-22/pdf/2020-28196.pdf.

4 *Id*. at 6742.

2000 Pennsylvania Avenue NW | Suite 4008 | Washington, D.C. 20006 | (202) 618-6464 | BetterMarkets.org

however, was a wholesale weakening of an important part of the regulatory framework Congress put in place in response to the waves of bank and thrift failures in the 1980s and early 1990s.[5] As documented in the preamble to the Proposal, the dollar amount of reported brokered deposits immediately plunged after the 2020 changes; reported brokered deposits dropped about $350 billion or roughly 32 percent during the quarter following the effective date of the rule.[6] This data confirms that the 2020 rule reclassified large swaths of deposits from being reported as brokered to being reported as normal deposits, making them exempt from the statutory safeguards that were intended to apply to brokered deposits.

The material weakening of the rules brought about by the 2020 changes will be described in this letter, but one change was so egregious from a procedural standpoint that it is worthy of singling out. This change established that a third party that places deposits with only ***one bank*** will not be deemed a deposit broker by the FDIC.[7] This fundamental reinterpretation of the Federal Deposit Insurance Act ("FDI Act") created a brokered deposit loophole for so-called exclusive deposit placement arrangements of the type used by a partner bank and the crypto firm Voyager Digital Holdings, Inc.,[8] before that crypto firm's July, 2022 bankruptcy.[9] This reinterpretation of the law had not even been included in the FDIC's notice of proposed rulemaking that preceded the 2020 changes ("2020 NPR").[10] Reportedly, the provision was only inserted into the preamble to the final rule for distribution to FDIC Board members ***the day before they voted on the rule***.[11]

As a result of the 2020 rule changes, weak institutions will be able to do precisely what the law was intended to prevent: prop themselves up and increase risk with large quantities of retail deposits bundled by third parties, acting both in economic substance and according to the plain statutory language, as deposit brokers, while being purposefully not covered by the FDIC's rules. Moreover, by failing to require that brokered deposits be reflected as such in Call Reports, the 2020 rule changes present banking supervisors and the public, including investors and other counterparties, with a materially distorted and overly optimistic picture of the liquidity risks present in banks' liability structures.

Better Markets strongly supports the Proposal. The proposed amendments adhere much more closely to the plain language of the statutory brokered deposit provisions than do the current

---

5 *See* Better Markets Comment Letter, *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions* (June 9, 2020), https://www.fdic.gov/system/files/2024-06/2020-unsafe-unsound-banking-practices-brokered-deposits-3064-ae94-c-109.pdf.

6 Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68244.

7 12 C.F.R. § 337.6(a)(5)(ii).

8 Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68245.

9 *See In re Voyager Digital Holdings, Inc.*, No. 22–10943 (Bankr. S.D.N.Y. July 6, 2022).

10 Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions; RIN: 3064-AE94; Document Number 2019-28275; 85 Fed. Reg. 7453 (Feb. 10, 2020), https://www.govinfo.gov/content/pkg/FR-2020-02-10/pdf/2019-28275.pdf.

11 *See* Federal Deposit Insurance Corporation, *Statement by FDIC Board Member Martin J. Gruenberg on the Final Rule: Brokered Deposits and Interest Rate Restrictions at the FDIC Board Meeting* (Dec. 15, 2020), https://www.fdic.gov/news/speeches/2020/spdec1520f.html.

regulations following the 2020 changes. And the proposed amendments will better support the safety and soundness of the U.S. banking system.

BACKGROUND

Insured depositors in a federally insured bank or thrift do not need to worry about the safety of their funds if they are within the insurance limit. This makes banks less likely to experience deposit runs, and makes the financial system more stable. At the same time, though, misaligned incentives associated with the federal deposit insurance guarantee can greatly increase costs to the FDIC and, in extreme scenarios, to taxpayers. In particular, some banks may choose to adopt imprudent growth strategies funded by insured deposits, or may get into trouble and decide to "gamble for resurrection," funding their risky bets with insured deposits. This concern is generally less acute for banks that fund themselves with relatively stable relationship-based deposits (such as personal savings accounts), and more acute for banks that choose to source their deposits from wholesale sources such as brokers, which are much more likely to take those deposits out of the bank quickly for a variety of possible reasons.

Such concerns have attracted the attention of bank regulators for more than 50 years. The Proposal cites regulatory concerns with brokered deposits from as early as a 1973 FDIC Division of Bank Supervision Manual.[12] It also describes how brokered deposits contributed to the rapid growth and high-risk lending that led to the 1982 failure of Penn Square Bank, and how loans sold by Penn Square contributed to the subsequent collapse of, and federal assistance provided to, Continental Illinois Bank.[13]

The level of concern, even in the early 1980s, was already sufficient to cause the FDIC and the former Federal Home Loan Bank Board ("FHLBB") to issue an advance notice of proposed rulemaking ("1983 ANPR") in November 1983,[14] followed by proposed rules and final rules in 1984[15] that limited the deposit insurance coverage available to brokered deposits.[16] The 1983 ANPR described the issue with brokered deposits as follows:

> The FDIC and the Board are concerned that the above-described deposit placement practices enable virtually all institutions to attract large volumes of funds from outside their natural market area irrespective of the institutions' managerial and

12 Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68246.

13 *Id*.

14 *See* Brokered Deposits; 48 Fed. Reg. 50339 (Nov. 1, 1983), https://archives.federalregister.gov/issue_slice/1983/11/1/50313-50358.pdf#page=27, ("1983 ANPR").

15 *See* Brokered Deposits, Limitations on Deposit Insurance; 49 Fed. Reg. 2787 (Jan. 23, 1984), https://archives.federalregister.gov/issue_slice/1984/1/23/2783-2791.pdf (proposed rule); Brokered Deposits, Limitations on Deposit Insurance; 49 Fed. Reg. 13003 (Apr. 2, 1984), https://archives.federalregister.gov/issue_slice/1984/4/2/13002-13012.pdf (final rule).

16 For an extensive discussion of the 1984 brokered deposit rules, *see* Federal Deposit Insurance Corporation, *Study on Core Deposits and Brokered Deposits* (July 8, 2011), https://www.fdic.gov/regulations/reform/coredeposit-study.pdf.

> financial characteristics. The ability to obtain de facto one-hundred-percent deposit insurance through the parceling of funds eliminates the need for the depositor to analyze institutions' likelihood of continued financial viability. The availability of these funds to all institutions, irrespective of financial and managerial soundness, reduces market discipline. [and increases costs to the deposit insurance funds by allowing unsound institutions to remain open beyond the time when normal market forces would have caused them to fail][17]

In 1985, however, in response to a lawsuit filed by the securities industry, a court found the brokered deposit rules of the FDIC and FHLBB invalid because they limited deposit insurance coverage in a way that exceeded those agencies' statutory authorities.[18]

With these rules struck down, brokered deposits continued to fuel growth and risk taking by non-viable thrifts, strongly contributing to and greatly increasing the cost of the 1980s thrift crisis.[19] As noted in the Proposal, the misuse of brokered deposits as a contributor to the thrift crisis became the subject of Congressional hearings. The Proposal, for example, quotes 1990 testimony from the President of the Independent Bankers Association:

> One of the lessons from the thrift crisis is their ability to gather deposits through brokered deposits and increase the size of the institution and the funds they had available very rapidly without additional capital and, quite frankly, without additional management. Then, to take these funds out and invest them in what turned out to be very risky matters, is certainly a lesson America has to learn and look at.[20]

Based on the abundant evidence of how the misuse of brokered deposits can drive up the cost to taxpayers of the federal deposit insurance system, in 1989 Congress placed restrictions on some banks' use of brokered deposits with the enactment of section 29 of the FDI Act.[21] Under the statute, well-capitalized banks (we will use the word "banks" to encompass both banks and thrifts) face no restrictions. Banks that fail to meet their minimum capital requirements ("undercapitalized banks") may not accept deposits from a "deposit broker;" and banks that meet their minimum capital requirements but are not well-capitalized ("adequately capitalized banks") may only accept deposits from a deposit broker if they have a waiver from the FDIC.

For purposes of implementing these restrictions, the key term is "deposit broker," and it is defined in law to include, among other persons, "any person that is in the business of placing

---

[17] 1983 ANPR, *supra* note 14, at 50340.

[18] For a discussion, *see* 2011 Study *supra* note 16, at 12-13, citing *FAIC Securities, Inc. v. United States*, 768 F.2d 352 (D.C. Cir. 1985).

[19] *See, e.g.*, George G. Kaufman, *The Savings and Loan Rescue of 1989: Causes and Perspective*, Federal Reserve Bank of Chicago, Working Paper 1989-23 (Nov. 1989), https://fraser.stlouisfed.org/files/docs/historical/frbchi/workingpapers/frbchi_workingpaper_1989-23.pdf.

[20] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68246.

[21] 12 U.S.C. § 1831f.

deposits or facilitating the placement of deposits in insured depository institutions."[22] That said, the law goes on to designate nine situations in which a person is ***not*** a deposit broker. The ninth exception is "an agent or nominee whose primary purpose is not the placement of funds with depository institutions."[23] Section 29 of the FDI Act also includes restrictions on the interest rates that certain troubled institutions can pay on their deposits. Since the Proposal would not change the FDIC's implementing regulations for the interest rate restrictions, we will not discuss those restrictions in this letter.

Since the brokered deposit restrictions were enacted in law in 1989, experience with bank failures, and a number of studies, have continued to demonstrate the risks to banks and the cost to the FDIC's Deposit Insurance Fund ("DIF") from overreliance by banks on brokered deposits. The Proposal describes how, for the bank failures occurring between 2007 and 2017, the FDIC incurred disproportionally high losses from failed banks that had relied heavily on brokered deposits.[24]

The Proposal also cites the findings of a statutorily required study of core and brokered deposits, that the FDIC completed in 2011.[25] That study found that higher brokered deposit use was associated with a higher probability of bank failure and higher DIF losses.[26] Similarly, a 2017 FDIC study of the 2008 banking crisis found that bank failures and supervisory ratings downgrades were more frequent among banks that made greater use of wholesale funding sources, including brokered deposits.[27]

In their retrospective reviews of the causes of bank failures, the Inspectors General of the federal banking agencies have reached similar conclusions. These reports described how brokered deposits contributed to bank failures by allowing institutions with concentrations in risky loan portfolios to grow rapidly. Relevant Inspectors General reports include:[28]

- Safety and Soundness: Analysis of Bank Failures Reviewed by the Department of the Treasury Office of Inspector General, OIG–16–052, August 15, 2016;
- Summary Analysis of Failed Bank Reviews, Board of Governors of the Federal Reserve System, Office of Inspector General, September 2011; and
- Follow Up Audit of FDIC Supervision Program Enhancements, FDIC Office of Inspector General, Report No. MLR–11–010, December 2011.

---

22 12 U.S.C. § 1831f(g)(1)(A).

23 12 U.S.C. § 1831f(g)(2)(I).

24 Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68246.

25 Federal Deposit Insurance Corporation, *supra* note 16.

26 *Id.* 3.

27 FEDERAL DEPOSIT INSURANCE CORPORATION, CRISIS AND RESPONSE: AN FDIC HISTORY, 2008–2013 at 121–22 (2017), https://www.fdic.gov/publications/crisis-and-response-fdic-history-2008-2013.

28 *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions; RIN 3064-AE94; 84 Fed. Reg. 2366 at 2369–70 (Feb. 6, 2019), https://www.govinfo.gov/content/pkg/FR-2019-02-06/pdf/2018-28273.pdf.

More recently, the FDIC's 2019 advance notice of proposed rulemaking, which preceded its 2020 proposed and final rules, contained an extensive statistical analysis of the role of brokered deposits in bank failures, thereby updating the analysis in its 2011 study.[29] In its updated analysis, the FDIC wrote, "To summarize the results in this section, we find that ***brokered deposit use is associated with higher probability of bank failure and higher insurance fund loss rates***."[30]

In short, not only are the brokered deposits restrictions required by law, the overwhelming evidence from 50 years of experience with bank failures is that they are an important and conceptually well-founded prudential safeguard. It is worth commenting, therefore, on the FDIC's rationale for the 2020 changes. The "Policy Objectives" section of the 2020 NPR stated:

> [T]he FDIC intends to modernize its brokered deposit regulations to reflect recent technological changes and innovations that have occurred.[31]

That Notice argued that the types of deposits that were proposed to be excluded from being reported as brokered may not be as risky as traditional brokered certificates of deposit (which the 2020 rule continued to classify as brokered):

> The behavior of other types of deposit placement arrangements, such as deposits placed through sweeps or that underlie prepaid card programs, may be more based on a business relationship than on interest rate competition. Given limitations on available data, however, historical studies have not been able to differentiate the experience of banks based on the different types of deposits accepted.[32]

The qualifying language here suggests, on its face, that the FDIC lacked credible empirical data to justify its de-regulatory approach to brokered deposits. Moreover, since the 2020 changes were finalized, events have continued to demonstrate that brokered deposits, including deposits specifically excluded by the 2020 changes from being labeled as such, carry significant risk. The Proposal notes that the crypto firm Voyager Digital Services, Inc., which entered bankruptcy in July 2022, had entered into an exclusive deposit placement arrangement with a partner bank. By any reasonable interpretation, Voyager was in the business of placing deposits into its partner bank, but those deposits were not considered brokered deposits under the 2020 changes. The Proposal also notes that the failed First Republic Bank experienced a run on affiliated sweep deposits before

---

29 *Id.* at 2384-2400.

30 *Id*. at 2385 (emphasis added).

31 Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 10, at 7453.

32 *Id*. at 7464.

it failed,[33] illustrating that the policy rationale for a regulatory brokered deposit exception for sweep deposits—their alleged or hoped-for stability—is inadequate.

SUMMARY OF THE PROPOSAL

The Proposal would amend parts 337.6 and 303.243 of the FDIC regulations.[34] Currently, Part 337.6 repeats the statutory definition of "deposit broker," which includes, among other things, two prongs: "in the business of placing deposits of third parties with insured depository institutions," and "facilitating the placement of deposits of third parties with insured depository institutions." The regulation defines each of those two prongs of the definition of deposit broker, and then proceeds to list the nine statutory exceptions identifying when a person is not a deposit broker. The ninth of these is that the term "deposit broker" does not include, "an agent or nominee whose primary purpose is not the placement of funds with depository institutions." Since an entity that enjoys such an exception is not a deposit broker, the deposits it places at banks are not brokered deposits. This ninth exception, known as the Primary Purpose Exception, is available for a list of "designated business exceptions," some of which require an application or notice to the FDIC. The Primary Purpose Exception also is available in circumstances not identified by the list of designated business exceptions, but only upon application to the FDIC. The applications process is described in part 303.243.

The Proposal includes a number of important changes to the current rules, including these:

- **Expanding and Clarifying the Definition of Deposit Placement:** The Proposal would replace the two separate definitions of "in the business of placing deposits of third parties with insured depository institutions," and "facilitating the placement of deposits of third parties with insured depository institutions," with a single list of five activities; a person that engages in any one of these five activities would be deemed to be "engaged in the business of placing or facilitating the placement of deposits."

- **Closing the Single Bank Placement Loophole:** Importantly, the Proposal would eliminate language introduced by the 2020 changes, that excluded an entity that placed deposits *in only one bank* from being considered "in the business of placing deposits," or "in the business of facilitating the placement of deposits." This would end the loophole introduced by the 2020 changes for exclusive deposit placement arrangements in which a bank could source up to 100 percent of its deposits from, as an example, a single fintech firm, while not reporting any of the deposits as brokered.

- **Including the Receipt of Fees for Deposit Placement:** The Proposal's list of five activities also includes the entity's receipt of fees for the placement of deposits, a factor that had long been considered by the FDIC but was eliminated by the 2020 changes.

---

[33] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68245.

[34] 12 C.F.R. § 337.6 and 12 C.F.R. § 303.243.

- **Replacing the Matchmaking Criteria With a More Expansive Test:** The activities list would exclude the "matchmaking" criteria introduced by the 2020 changes and replace them with new criteria regarding allocation of deposits. As described below, the matchmaking criteria are nominally designed to identify persons involved in determining or proposing deposit allocations, but the criteria are so restrictive that, as explained below, almost no one is likely to be deemed a deposit broker under them.

- **Narrowing the Designated Business Exceptions:** The Proposal also would change the designated business exceptions to the definition of deposit broker. The 2020 changes introduced new designated business exceptions under which a bank could qualify for the primary purpose exception, and introduced an application process that laid out new factors that the FDIC would use to decide whether to grant an exception. As discussed below, the Proposal would amend one of the designated business exceptions introduced in 2020, remove another, and amend the factors that would result in an approval of an application for the primary purpose exception.

- **Tightening the Broker-Dealer Sweep Exception:** Specifically, the Proposal would amend the 2020 provision that granted a primary purpose exception to entities that sweep deposits in total amounts less than 25 percent of their assets under administration in a particular business line. Most notably, the Proposal would change the 25 percent number to 10 percent, the amount that prevailed—but only for affiliate sweeps and then only under conditions regarding the fees paid to the broker-dealer and only for non-maturity sweep deposits—during the years 2005-2020 pursuant to an FDIC Advisory Opinion (before 2005, FDIC staff had generally interpreted brokerage sweep accounts as brokered deposits).[35]

- **Suggesting Two Possible Treatments of Broker-Dealer Sweep Accounts:** The Proposal also presents two alternative treatments of broker-dealer sweep accounts. One of these would restore the pre-2020 requirement that a broker-dealer must be affiliated with the bank for any portion of its sweep accounts to qualify for an exclusion from being reported as brokered deposits. The other alternative would eliminate the exclusion for broker-dealer sweeps altogether, resulting in all broker-dealer sweep accounts being reported as brokered deposits.

- **Eliminating the Enabling Transactions Exception:** The Proposal also would eliminate the "enabling transactions" test introduced by the 2020 changes. That test provides a primary purpose exception to an entity for which "100 percent of depositors' funds that the agent or nominee places, or assists in placing, at depository institutions are placed into transactional accounts that do not pay any fees, interest, or other remuneration to the depositor."[36] Prior to the 2020 changes, in evaluating primary

[35] For a discussion of the historical evolution of the FDIC's approach to determining whether the primary purpose exception should apply to sweep deposits, *see* 2011 Study, *supra* note 16, at 25-27.

[36] 12 C.F.R. § 337.6(a)(5)(v)(I)(1)(ii).

> purpose exception requests, the FDIC had not drawn a distinction between placing deposits and placing deposits for the purpose of enabling transactions.[37]

Finally, both the 2020 rule and the Proposal describe an application process by which an entity can seek approval for a primary purpose exception in circumstances that are not addressed by the list of designated business exceptions. The current rule, which reflects the 2020 changes, states that (for primary purpose applications other than those for the enabling transactions exception, which are handled separately) the FDIC will approve the application if the applicant demonstrates that, with respect to the particular business line under which the third party places or facilitates the placement of deposits, the primary purpose of the third party's business relationship with its customers is a purpose other than the placement or facilitation of the placement of deposits.[38]

In contrast, the Proposal states that the FDIC will approve the application if

> the applicant demonstrates that, with respect to the particular business line under which the third party places or facilitates the placement of deposits, the primary purpose of the third party's business relationship with the insured depository institution is for a substantial purpose other than to provide a deposit placement service or FDIC deposit insurance for customer funds placed at the insured depository institution.

The preamble to the Proposal explains that before the 2020 changes, the FDIC had evaluated requests for the Primary Purpose exception based on whether the relationship between the third party *and the bank* was for a substantial purpose other than providing a deposit placement service or deposit insurance. Thus, if this aspect of the Proposal is adopted, the FDIC would return to the conceptual framework for the analysis of these applications that existed prior to the 2020 changes.

The Proposal includes a number of questions for the public. Better Markets' responses to a number of these questions, and to the Proposal more generally, are summarized below, and discussed in more detail in the subsequent section.

<u>SUMMARY OF COMMENTS</u>

Better Markets strongly supports the Proposal. Several elements of the 2020 changes undermined an important statutory safeguard intended to address the perverse incentives faced by poorly capitalized, but federally insured, depository institutions. The Proposal carefully, thoughtfully, and correctly explains why those elements need to be changed to better conform to the language and underlying purpose of the law. Better Markets' comments, summarized below and discussed in more detail in the next section, are as follows:

---

[37] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68257.

[38] 12 C.F.R. § 303.243(b)(4)(v)(B).

I. In accordance with the Proposal, the definition of deposit broker should not exclude entities that place deposits in only one bank.
II. The proposed deposit allocation criteria are a vast improvement over the current matchmaking criteria.
III. In accordance with the Proposal, an entity's receipt of fees for the placement of deposits should be included in the list of factors used to determine whether that entity is in the business of placing deposits or facilitating the placement of deposits.
IV. To further strengthen the Proposal, the list of factors that would cause an entity to be viewed by the FDIC as in the business of placing deposits or facilitating the placement of deposits should not be an exhaustive list but should instead give the FDIC discretion to include entities it determines to be, in substance, in the business of placing deposits or facilitating the placement of deposits.
V. The Proposal's criteria for the evaluation of primary purpose exception requests, which focuses on the relationship between the person placing the deposits and the bank, is an important improvement over the current rule.
VI. The proposed change in the numerical threshold under the Broker-Dealer Sweep exception from 25 percent to 10 percent, and the elimination of the enabling transactions exception, are warranted.
VII. In response to a question addressed to the public in the Proposal, Primary Purpose Exceptions granted pursuant to the 2020 rule's 25 percent Broker-Dealer Sweep exception and its enabling transactions exception should not be grandfathered.
VIII. In response to a question addressed to the public in the Proposal, the enabling transactions exception should not be retained for non-reloadable gift cards.
IX. The Broker-Dealer Sweep Exception should be eliminated, in accordance with one of the two alternative approaches presented for comment.

COMMENTS

I. IN ACCORDANCE WITH THE PROPOSAL, THE DEFINITION OF DEPOSIT BROKER SHOULD NOT EXCLUDE ENTITIES THAT PLACE DEPOSITS IN ONLY ONE BANK.

Better Markets agrees with the Proposal's elimination of the exclusive deposit placement exception. That exception, introduced in the 2020 changes, relies on a specific use of the plural in the statutory definition of deposit broker. By that definition, a deposit broker includes "... any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties ***with insured depository institutions***."[39] In the notice announcing the final rule, the FDIC argued that the statute's use of "institutions" in the plural—and its assertion that deposits obtained through an exclusive placement arrangement would likely be more stable than traditional brokered deposits—justified the FDIC in establishing by regulation that a person placing deposits

[39] 12 U.S.C. § 1831f(g)(1) (emphasis added)

with only one institution is not a deposit broker.[40]

As noted in the Proposal, the FDIC had never taken this approach at any point since the brokered deposit provisions became law in 1989, and nor had the interagency Call Report instructions told banks that deposits obtained from exclusive deposit placement arrangements were excluded from being reported as brokered. The Proposal also explains that "This prior approach was consistent with the general statutory interpretation rule that provides that words importing the plural include the singular, unless the statutory context indicates otherwise."[41]

As noted above, the FDIC did not formally propose or seek public comment on this fundamental reinterpretation—and relaxation—of the law. Had the FDIC inserted in the final rule such a material and surprising *tightening* of its rule without having solicited public comment, banking industry groups would doubtless have sued immediately. On procedural grounds alone, the exclusive deposit placement exception never should have been finalized.

The exclusive deposit placement exception also undercuts the underlying policy purpose of the statute to curtail the ability of less than well-capitalized banks to continue to fund risky bets by trading on the deposit insurance guarantee. It allows a weak bank to obtain, and grow, up to 100 percent of its deposits in the form of third-party deposits placed by entities such as Voyager, as described above, or other fintech or crypto entities, without identifying these deposits as brokered. These third-party deposits are in no sense stable relationship deposits, but can exhibit volatility if either the bank, or the company placing the deposits, gets into trouble. Even in an exclusive deposit placement arrangement, if the bank gets into serious trouble, the deposit placing entity would most likely search for another bank partner and wind down its placements with the troubled bank. The result of the exception is to allow a fundamentally incorrect labeling of the stability of the bank's deposits on its Call Reports, which could seriously mislead its counterparties.

II. <u>THE PROPOSED DEPOSIT ALLOCATION CRITERIA ARE A VAST IMPROVEMENT OVER THE CURRENT MATCHMAKING CRITERIA.</u>

Better Markets supports the proposed deposit allocation criterion, which would replace the "matchmaking" criteria in the 2020 rule. Specifically, the proposed deposit allocation criterion simply states that a person that "…proposes or determines deposit allocations at one or more insured depository institutions," would be deemed to be "in the business of placing deposits or facilitating the placement of deposits."[42]

---

[40] 2020 rule, *supra* note 3, at 6745.

[41] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68253, citing 1 U.S.C. § 1.

[42] Proposed 12 C.F.R. § 337.6(a)(5)(ii)(D).

The matchmaking criteria in the 2020 rule also deal with persons who are involved in determining or proposing deposit allocations, and who thereby would be deemed in the business of facilitating the placement of deposits. The current matchmaking criteria, however, contain four carve-outs that severely limit the set of persons that would ever be deemed to be engaged in matchmaking activities. The carve-outs are:[43]

- If the deposits are allocated to only one bank, there is no matchmaking;
- If an affiliate of the bank or banks allocates the deposits, there is no matchmaking;
- If the person allocating the deposits does not have specific financial information about the depositor, and base the allocation on this information, there is no matchmaking; and
- If the person allocating the deposits does not have specific information about the deposit balance objectives of the receiving banks, and base the allocation on this information, there is no matchmaking.

For example, under these matchmaking exclusions, a person that is in the business of determining third party deposit allocations among banks, but those allocations are not based on specific information available to the person about both the depositor and the deposit balance objectives of the banks, would not be deemed to be facilitating the placement of deposits. However, common sense says that such a person ***is*** facilitating the placement of deposits. Similarly, common sense says that bank affiliates can facilitate the placement of deposits among affiliated banks—but they can never be found to do so under the matchmaking criterion.

At least optically, the matchmaking exclusions give the appearance of being designed to ensure that few persons ever qualify as matchmakers, or to provide a roadmap for any person who wishes to avoid being designated as a deposit broker because of this criterion. In reality, some persons do facilitate the placement of deposits by determining or proposing deposit allocations among banks, even where they are covered by one of the existing exclusions.

For all these reasons, Better Markets supports the Proposal's simple and straightforward deposit allocation test, which appropriately identifies and characterizes deposit allocation activity that should be treated as deposit brokering activity.

III. IN ACCORDANCE WITH THE PROPOSAL, AN ENTITY'S RECEIPT OF FEES OR REMUNERATION FOR THE PLACEMENT OF DEPOSITS SHOULD BE INCLUDED IN THE LIST OF FACTORS DETERMINING WHETHER THAT ENTITY IS IN THE BUSINESS OF PLACING DEPOSITS OR FACILITATING THE PLACEMENT OF DEPOSITS.

Better Markets supports the Proposal's inclusion of fees received by the person placing third-party deposits in the list of five factors, any one of which would cause the FDIC to determine that the person is in the business of placing deposits or facilitating the placement of deposits. Specifically, item E of the proposed five factors is

[43] 12 C.F.R. § 337.6(a)(5)(iii)(C).

> The person has a relationship or arrangement with an insured depository institution or customer where the insured depository institution or the customer pays the person a fee or provides other remuneration in exchange for deposits being placed at one or more insured depository institution.[44]

This would amend the current rule which, as a result of the 2020 changes, does not mention the receipt of fees remuneration as a factor in the definition of whether a person is in the business of placing, or facilitating the placing of, deposits.

As noted in the Proposal, before the 2020 changes took effect, a person's receipt of fees or other remuneration was consistently a factor used by FDIC staff in reaching decisions about whether that person was in the business of placing deposits or facilitating the placement of deposits.[45] Better Markets believes this is an appropriate, common-sense test that is consistent with the plain English meaning of the words, "being in the business of." Moreover, satisfaction of this definitional criteria for "in the business" does not bar the person from qualifying for one of the statutory exceptions to the definition of deposit broker.

IV. TO FURTHER STRENGTHEN THE PROPOSAL, THE LIST OF FACTORS THAT WOULD CAUSE AN ENTITY TO BE VIEWED BY THE FDIC AS IN THE BUSINESS OF PLACING DEPOSITS OR FACILITATING THE PLACEMENT OF DEPOSITS SHOULD NOT BE AN EXHAUSTIVE LIST BUT SHOULD INSTEAD GIVE THE FDIC DISCRETION TO INCLUDE ENTITIES IT DETERMINES TO BE, IN SUBSTANCE, IN THE BUSINESS OF PLACING DEPOSITS OR FACILITATING THE PLACEMENT OF DEPOSITS.

As Better Markets wrote in response to the 2020 NPR, it is inappropriate to rely solely on a specific, exhaustive list of factors to identify whether a person is "facilitating" the placement of deposits.[46] "Facilitating," in ordinary usage, means to help bring something about. Facilitating the placement of deposits could be done in any number of ways that might not correspond to the factors in a list but might nevertheless satisfy the ordinary understanding of the word "facilitating."

All of the five elements in the Proposal clearly would justify the initial definitional finding that a person is "in the business" (again, subject to the further test whether any of the statutory or designated business exceptions apply). But it is inconsistent with the inherent fact-specific nature of these determinations that this list of five factors is an exhaustive list. Just as the list of designated business exceptions allows for FDIC discretion in granting primary purpose exceptions through an application process, the FDIC should also have discretion to evaluate unique circumstances when it determines whether a person is in the business of placing deposits or facilitating the placement of deposits.

---

[44] Proposed 12 C.F.R. § 337.6(a)(5)(ii)(E).

[45] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68252.

[46] See Better Markets Comment Letter, *supra* note 5, at 11-12.

V. THE PROPOSAL'S CRITERIA FOR THE EVALUATION OF PRIMARY PURPOSE EXCEPTION REQUESTS, WHICH FOCUSES ON THE RELATIONSHIP BETWEEN THE PERSON PLACING THE DEPOSITS AND THE BANK, IS AN IMPORTANT IMPROVEMENT OVER THE CURRENT RULE.

Proposed section 303.243 of the FDIC's regulations states that the FDIC will approve applications for the primary purpose exception (other than applications related to the 10 percent broker-dealer sweep exception, which are treated separately) if "the primary purpose of the third party's business relationship *with the insured depository institution* is for a substantial purpose other than to provide a deposit placement service or FDIC deposit insurance."[47]

Better Markets supports the Proposal's approach to evaluating these applications. The deposit placing entity's business relationship with its customers may be relevant to the primary purpose exception decision, and under the Proposal, this information would be provided and reviewed by the FDIC. But the business relationship between the deposit placing entity and the bank is of more fundamental importance: for example, is the deposit placing entity steering deposits to this bank in exchange for fees or other remuneration? If so, the deposit-placing activity falls squarely within any reasonable interpretation of the term "brokered deposits," yet under the current rule resulting from the 2020 changes, the FDIC may not consider the business relationship between the deposit placing entity and the bank.

VI. THE PROPOSED CHANGE IN THE NUMERICAL THRESHOLD UNDER THE BROKER-DEALER SWEEP EXCEPTION FROM 25 PERCENT TO 10 PERCENT, AND THE ELIMINATION OF THE ENABLING TRANSACTIONS EXCEPTION, ARE WARRANTED.

Many broker-dealers offer sweep accounts to their customers as a way to earn interest on uninvested cash. The uninvested funds are swept into bank accounts, or money market funds, at the end of each day, with the interest earnings split to varying degrees between the broker-dealer and the customer.[48] Reportedly, broker-dealers often keep most of the interest income on their customers' sweep account and return only a relatively small amount to the customers.

Apart from being accommodative to a standard industry practice, there is little substantive justification for *any* primary purpose exception for sweep accounts. These are third party deposit placement arrangements for the purpose of earning interest at insured banks and they are advertised to customers as part of the services provided by the broker-dealer. Broker-dealers earn considerable remuneration from these deposit placement arrangements in the form of a portion of the interest income from the swept balances that they keep. Were the bank to get into serious trouble, any responsible broker-dealer would most likely pull its sweep accounts from that bank.

---

[47] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68271. (emphasis added).

[48] Rachel Christian, *What happens to idle cash in your portfolio? Sweep accounts, explained*, BANKRATE.COM (Oct. 2, 2024), https://www.bankrate.com/investing/sweep-accounts/.

For these reasons, Better Markets does not support a designated business exception for broker-dealer sweeps and believes that any such exception that is granted should be crafted as narrowly as possible. Consequently, we support the proposed change in the numerical threshold for this exception from 25 percent, to its pre-2020 value of 10 percent.

As a result of the 2020 changes, the current rules also include a primary purpose exception in the form of a designated business exception when (with respect to a particular business line):

> 100 percent of depositors' funds that the agent or nominee places, or assists in placing, at depository institutions are placed into transactional accounts that do not pay any fees, interest, or other remuneration to the depositor.[49]

Interestingly, neither the 2020 NPR that preceded the 2020 changes, nor the 2020 final rule, attempted any meaningful justification for this new primary purpose exception. The relevant text in both documents is almost exclusively limited to describing how the exception would work. In the way of a justification, the 2020 NPR offers only the observation that under the conditions given, ". . . the FDIC would conclude that the primary purpose of the agent's or nominee's business is to enable payments."[50]

The statute defines deposit broker by reference to "placing deposits." Transaction accounts, including non-interest-bearing transaction accounts, have historically been large and important categories of bank deposits. Congress could have excluded the placement of these deposits from triggering the definition of a deposit broker, but it did not. The failure of the 2020 NPR and the final rule to make a conceptual case for this change, let alone explain the FDIC's legal authority to do so, was a serious shortcoming of those documents.

Since the transactions at issue require deposits as a precondition, Better Markets agrees with the Proposal that, ". . . there is no relevant difference between an agent or nominee's purpose in placing deposits to enable transactions and placing deposits to access a deposit account and deposit insurance."[51] Moreover, the third parties placing the deposits in these arrangements are likely receiving fees, interest income, or both from the bank. Were the bank to get into serious trouble, the entities placing the funds would likely begin to search for another bank and take steps to wind down placements to the troubled bank.

For all these reasons, Better Markets supports the proposed elimination of the enabling transactions exception.

[49] 12 C.F.R. § 337.6(a)(5)(v)(I)(1)(ii).

[50] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 10, at 7459.

[51] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, *supra* note 2, at 68257.

VII. IN RESPONSE TO A QUESTION ADDRESSED TO THE PUBLIC IN THE PROPOSAL, PRIMARY PURPOSE EXCEPTIONS GRANTED PURSUANT TO THE 2020 RULE'S 25 PERCENT BROKER-DEALER SWEEP EXCEPTION AND THE ENABLING TRANSACTIONS EXCEPTION SHOULD NOT BE GRANDFATHERED.

As indicated in comment six, above, Better Markets does not support the 2020 rule's 25 percent broker-dealer sweep exception and the enabling transactions exception. Grandfathering primary purpose exceptions made pursuant to these provisions would result in the grandfathered banks' Call Reports presenting a misleading picture of the liquidity risk of these institutions. Grandfathering these exceptions would allow these institutions to accept large amounts of third party, potentially volatile deposits, with the same risk characteristics as brokered deposits that *are* reported as such, but without disclosure.

For this reason, Better Markets does not support grandfathering primary purpose exceptions granted pursuant to these two provisions.

VIII. IN RESPONSE TO A QUESTION ADDRESSED TO THE PUBLIC IN THE PROPOSAL, THE ENABLING TRANSACTIONS EXCEPTION SHOULD NOT BE RETAINED FOR NON-RELOADABLE GIFT CARDS.

As indicated in comment six, above, Better Markets does not support the enabling transactions exception. Even though balances on these cards decline over time for individual card-holders, the omnibus accounts placed at a bank by the entity that operates the card program may be a large and growing funding source for that bank. Were the bank receiving this omnibus deposit to get into serious trouble, the card company would likely begin searching for another bank partner and would likely take steps to wind down its involvement with the troubled bank, resulting in potentially rapid shrinkage of the omnibus account. Creating a special carve-out to allow enabling transaction exceptions for these programs would not only be at variance with the plain language of the statute, as described above, but would allow banks in receipt of these deposits to present in their Call Reports a misleading picture of the stability of their deposit funding. For these reasons, Better Markets does not support allowing an enabling transactions exception for non-reloadable gift cards.

IX. THE BROKER-DEALER SWEEP EXCEPTION SHOULD BE ELIMINATED, IN ACCORDANCE WITH ONE OF THE TWO ALTERNATIVE APPROACHES PRESENTED FOR COMMENT.

As indicated in comment six, above, Better Markets does not support a designated business exception for broker-dealer sweeps, and believes that such exceptions should be eliminated, or failing that, crafted as narrowly as possible. Consequently, we were gratified that the FDIC requested comment on two alternative treatments of broker-dealer sweeps. One of these alternatives would limit the proposed exception for sweeps meeting a 10 percent threshold to broker-dealers that are affiliated with the bank. The other alternative would eliminate the broker-dealer sweep exception altogether.

The alternative that allows for an exception for sweeps within the 10 percent threshold only for affiliated broker-dealers creates a narrower set of exceptions than does the Proposal. Thus, for the reasons described in comment six, Better Markets believes this alternative is better than the Proposal's approach.

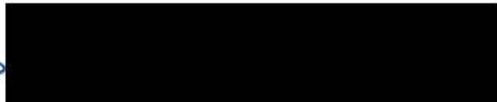
That said, eliminating the broker-dealer sweep exception altogether is an even better approach. An assumption that affiliate sweeps will be more stable than unaffiliated sweeps is unwarranted. The Proposal reported, as noted above, the run on affiliated sweeps experienced by First Republic Bank before its failure. Affiliated broker-dealers are separate legal entities. A broker-dealer that left sweep accounts in a troubled affiliated bank might be at risk of being perceived as failing to deal with its affiliate on an arms' length basis and under normal market terms, thereby placing its investors' funds at risk. This reputational concern could cause it to pull funds just as fast as if it were unaffiliated.

For these reasons, Better Markets believes that the elimination of broker-dealer sweep exceptions is the better of the two alternatives the FDIC has presented for public comment.

CONCLUSION

We hope these comments are helpful as the FDIC works to finalize its critically important amendments to its regulations governing brokered deposits.

Sincerely,



Shayna M. Olesiuk
Director of Banking Policy

Better Markets, Inc.